

FCC MAIL SECTION

Federal Communications Commission

FCC 98-101

JUN 8 8 49 AM '98

Before the
FEDERAL COMMUNICATIONS COMMISSION
 Washington, D.C. 20554

In the Matter of)
)
 Access Charge Reform for Incumbent) CC Docket No. 98-77
 Local Exchange Carriers Subject to)
 Rate-of-Return Regulation)

NOTICE OF PROPOSED RULEMAKING**Adopted: May 26, 1998****Released: June 4, 1998**

Comment Date: July 17, 1998

Reply Date: August 17, 1998

By the Commission:

	Table of Contents	Paragraph
I.	Introduction	1
	A. Overview	1
	B. Background	7
II.	Rate Structure Modifications	22
	A. Overview	22
	B. Common Line	23
	C. Local Switching	49
	D. Transport Services and the Transport Interconnection Charge (TIC)	61
	E. SS7 Signalling	73
III.	Other Issues	79
	A. General Support Facilities Costs	79
	B. Marketing Expenses	83
	C. Special Access	87
	D. Part 69 Cost Allocation Rules	91
	E. Modification of New Services Requirement	93
IV.	Procedural Issues	96
	A. <i>Ex Parte</i> Presentations	96
	B. Paperwork Reduction Act	97
	C. Initial Regulatory Flexibility Act Analysis	99
	D. Notice of Proposed Rulemaking Comment Filing Dates and Procedures	114
V.	Ordering Clauses	119

I. INTRODUCTION

A. Overview

1. In passing the Telecommunications Act of 1996 (1996 Act),¹ Congress sought to establish "a pro-competitive, de-regulatory national policy framework" for the United States telecommunications industry.² In this proceeding, as in others implementing the 1996 Act, we seek to unleash the dynamic forces of competition and deregulation in the telecommunications industry to serve the interests of the nation's consumers. We believe that our mandate from Congress directs us to foster the delivery of the benefits of competition to consumers throughout the country, and not only to those living in the most densely populated areas where the seeds of competition in local telecommunications markets may have already begun to take root.

2. Access reform is one of a series of actions that collectively are intended to foster and accelerate the introduction of efficient competition in all telecommunications markets, pursuant to the mandate of the 1996 Act. In the *Access Charge Reform Order*,³ we set in motion the forces of competition and deregulation in local telecommunications markets served by incumbent local exchange carriers (LECs) subject to price cap regulation. The 1996 Act, however, expressly provides that "Consumers in all regions of the Nation . . . should have access to telecommunications and information services . . . that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas."⁴ With this Notice of Proposed Rulemaking (NPRM),⁵ we commence a further proceeding on access reform to mobilize the same forces to serve the interests of consumers located in those rural and suburban areas that are served by incumbent LECs subject to rate-of-return regulation. The first step in this reform process is to enable these rate-of-return LECs to assess interstate access charges that are more consistent with principles of cost-causation and economic efficiency. Smaller, rate-of-return LECs currently are very concerned that their existing high per-minute rates for interstate access place them at a significant disadvantage in attempting to compete with new access service providers. In particular, these companies fear that the rate structures and levels mandated by our current access charge rules make their most lucrative customers, those that make many long distance calls, especially vulnerable to competing offers from new entrants. These rate-of-return LECs need to be allowed to move their rates to more economically efficient levels. Otherwise, they face the potential loss of

¹ Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, *codified at* 47 U.S.C. §§ 151 *et. seq* (1996 Act). Hereinafter, all citations to the 1996 Act will be to the 1996 Act as codified in the United States Code.

² S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. 1 (1996) (*Joint Explanatory Statement*).

³ *Access Charge Reform*, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982 (1997) (*Access Charge Reform Order*); Order on Reconsideration, 12 FCC Rcd 10119 (1997); *appeal pending sub nom. Southwestern Bell Tel. Co. v. FCC*, No. 97-2618 (and consolidated cases) (8th Cir. argued Jan. 15, 1998); Second Order on Reconsideration, 12 FCC Rcd 16606 (1997).

⁴ 47 U.S.C. § 254(b)(3).

⁵ A brief discussion of the genesis of the access charge structure, the current regulatory regime for incumbent LECs, and the uneconomic nature of certain of the access charge rate structure rules is contained in the "Background" section of the *Access Charge Reform Order*, 12 FCC Rcd at 15990-15998 ¶¶ 17 - 34.

customers to less efficient new entrants whose rates are lower than those currently assessed by the incumbent LECs, but higher than the rates these LECs would charge if our access charge rules were reformed. In addition, of course, reductions in interstate access charge per-minute rates should translate into lower per-minute long distance charges for consumers, which benefits both customers and carriers -- customers get more value for their money, and can afford to make more long distance calls, while carriers obtain additional revenues.

3. With this notice, we continue the process of reforming the access charge rate structure for rate-of-return LECs that was begun in the *Access Charge Reform Order* with the modifications to the transport rate structure, the reallocation of costs in the transport interconnection charge (TIC), and the amendments reflecting the changes necessary to implement universal service. In doing so, we intend to build on the analysis of the access charge rate structure developed in the *Access Charge Reform Order*. Prior to the adoption of the *Access Charge Reform Order*, price cap LECs were subject to essentially the same rate structure rules that currently apply to rate-of-return LECs. While rate-of-return LEC costs generally may be higher than price cap LEC costs due to longer loops or lower economies of scale, the two groups of carriers incur costs in the same manner, and similar economic principles should apply. Subject to receiving evidence showing that differences exist between price cap LECs and rate-of-return LECs that require different rules to achieve the goal of fostering an efficient, competitive marketplace, we propose to amend the access charge rules for rate-of-return LECs in a manner similar to that adopted for price cap LECs.

4. We recognize that access reform for the smaller, rate-of-return LECs may raise new or different issues that we did not have to address in our proceeding involving the typically larger, price cap LECs. For this and other reasons, we previously determined that we would address access reform for rate-of-return LECs in a separate proceeding. We further recognize that differences in the circumstances of rate-of-return and price cap incumbent LECs may require different approaches to reform, including a different transition to more economically efficient, cost-based interstate access charges. We seek to ensure that, at the end of the transition, all Americans enjoy the benefits of competition. By varying the transitional mechanisms, we can ensure that the process of getting to those benefits is as smooth as possible.

5. In this notice we propose to reform the access charge rate structure of rate-of-return LECs. We address many of the most fundamental economic inefficiencies in the current structure and will lay a foundation on which to develop further initiatives for rate-of-return LECs, including the rural LECs, most of whom are subject to rate-of-return regulation. In a subsequent phase of this proceeding, we intend to address the very difficult question of when, and how much, additional pricing flexibility should be afforded to rate-of-return LECs. We also intend to address, in a future proceeding, alternative forms of regulation for LECs currently subject to rate-of-return regulation. Such alternative regulatory structures could offer incentives to rate-of-return LECs that are able to become more efficient.

6. The *Access Charge Reform Order* and the *Universal Service Order* made the modifications necessary to implement the revisions to the universal service support mechanisms adopted in the *Universal Service Order*.⁶ This notice is not intended to address contentions that some additional costs

⁶ The sole exception is the development of the CCL rate for the National Exchange Carrier Association (NECA) common line pool. That issue was addressed in a separate order in response to NECA's petition for reconsideration or, in the alternative, a waiver, filed July 11, 1997. *Access Charge Reform*, CC Docket No. 96-262, Second Order on Reconsideration and Memorandum Opinion and Order, 12 FCC Rcd 16606 (1997).

or services should receive universal service support; those matters will be resolved in the Universal Service proceeding. We note that the Commission has determined that there shall be no change in the existing high cost support mechanisms for rural LECs until January 1, 2001, at the earliest. This means that, in the interim, the amount of universal service support for rural local exchange carriers will be maintained initially at existing levels and should increase in accordance with specified factors, such as inflation, that have historically guided changes in such support.

B. Background

1. Telecommunications Act Implementation

7. In the *Local Competition Order*,⁷ the Commission set forth rules to implement section 251 and section 252 of the Communications Act of 1934, as amended.⁸ As with all of Part II of Title II of the Communications Act, those sections, and the rules implementing them, seek to remove the legal, regulatory, economic, and operational barriers to telecommunications competition. Among other things, sections 251 and 252 provide entrants with the opportunity to compete for consumers in local markets by constructing new facilities, leasing unbundled network elements, and reselling telecommunication services. The Act, however, places limits on the applicability of sections 251(b) and (c) to smaller incumbent LECs. Section 251(f)(1), for instance, provides for exemption from the requirements in section 251(c) for rural telephone companies under certain circumstances. Moreover, section 251(f)(2) permits LECs with fewer than 2 percent of the nation's subscriber lines to petition for suspension or modification of the requirements in sections 251(b) or (c).

8. In the *Universal Service Order*,⁹ we took steps, following recommendations of a Federal-State Joint Board,¹⁰ to ensure that the support mechanisms necessary to maintain local rates at affordable levels are protected and advanced as local telecommunications markets become subject to the competitive pressures unleashed by the 1996 Act. Specifically, we established explicit support mechanisms to assist users in high-cost areas, low-income consumers, schools, libraries, and rural health care providers. The rules we adopted also provided for the funding of such support. Through the *Universal Service Order* and the *Access Charge Reform Order*, we set in place rules that identify and convert existing federal universal service support in the interstate high cost fund, the dial equipment minutes (DEM) weighting program, Long Term Support, Lifeline, and Link-up, to explicit federal universal service support mechanisms for both price cap and rate-of-return LECs. In the *Access Charge Reform Order*, we further directed that federal universal service support received by

⁷ *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499 (1996) (*Local Competition Order*), Order on Reconsideration, CC Docket No. 96-98, 11 FCC Rcd 13042 (1996), *vacated in part sub nom. Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *cert. granted sub nom. AT&T Corp. v. Iowa Utils. Bd.*, 118 S.Ct. 879 (1998).

⁸ 47 U.S.C. §§ 251 and 252.

⁹ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, First Report and Order, 12 FCC Rcd 8776 (1997) (*Universal Service Order*).

¹⁰ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, 12 FCC Rcd 87 (1996).

incumbent LECs be used to reduce or satisfy the interstate revenue requirement otherwise collected through interstate access charges.¹¹

9. In the *Access Charge Reform Order*, we began the process of reforming access charges for price cap LECs. There, we concluded that implicit subsidies embodied in the existing system of interstate access charges cannot be maintained indefinitely in their current form. We therefore modified the rules governing the interstate access charges of price cap LECs. First, we reformed the current rate structure to bring it more into line with cost-causation principles, phasing out significant implicit subsidies. Specifically, we reduced usage-sensitive interstate access charges by phasing out local loop and other non-traffic-sensitive (NTS) costs from those charges and directing price cap LECs to recover those NTS costs through more economically efficient, flat-rated charges. Second, we set in place a process to move the baseline rate level toward competitive levels by relying in part on emerging competition in local telecommunications markets, spurred by the adoption of the 1996 Act, to help identify the differences between the rates for interstate access services established by price cap LECs and those that competition would set. We also adopted revised rules governing the provision of transport services by both price cap and rate-of-return LECs. These rules included the reallocation of revenues presently recovered through the transport interconnection charge (TIC). These transport revisions responded to the decision of the United States Court of Appeals for the District of Columbia in *CompTel v. FCC*.¹² Finally, we deferred to a subsequent order the development of detailed rules for implementing the market-based approach for price cap LECs.

10. As noted in the *Access Reform NPRM*,¹³ the Part 69 rules were designed to promote competition in the interstate, interexchange market by ensuring that all interexchange carriers (IXCs) would be able to originate and terminate their traffic over incumbent LEC networks at just, reasonable, and non-discriminatory rates. While the Part 69 rules expressly contemplated competition in the interexchange market, they were not designed to address the potential effects of competition in the local exchange and exchange access market. Indeed, these rules reflected conditions in the telecommunications marketplace in 1983, when the incumbent LEC was the monopoly provider of local exchange and exchange access services. In addition, the Part 69 rules were designed to be consistent with the jurisdictional separations rules that govern the allocation of incumbent LECs' expenses and investment between the interstate and state jurisdictions.¹⁴ Consequently, the Part 69 access charge system likely reflects any jurisdictional cost misallocations mandated by our current separations rules. The Commission has initiated a related proceeding to examine our jurisdictional separations rules in light of the 1996 Act.¹⁵

¹¹ *Access Charge Reform Order*, 12 FCC Rcd at 16148 ¶ 381.

¹² *Competitive Telecommunications Ass'n v. FCC*, 87 F.3d 522 (D.C. Cir. 1996) (*CompTel v. FCC*).

¹³ *Access Charge Reform*, CC Docket No. 96-262, Notice of Proposed Rulemaking, Third Report and Order and Notice of Inquiry, 11 FCC Rcd 21354 (1996) (*Access Charge Reform NPRM*).

¹⁴ See 47 C.F.R. Part 36.

¹⁵ *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Notice of Proposed Rulemaking, 12 FCC Rcd 22120 (1997).

11. The Commission has recognized in prior rulemaking proceedings that, to the extent possible, costs of interstate access should be recovered in the same way that they are incurred, consistent with principles of cost-causation.¹⁶ Thus, the cost of traffic-sensitive access services should be recovered through corresponding per-minute access rates. Similarly, NTS costs should be recovered through fixed, flat-rated fees. The Commission has not, however, always adopted rules consistent with this goal. As a result, rate-of-return LECs are required to maintain rate structures that have been widely criticized as economically inefficient. For example, even though the costs of the local loop do not vary with the amount of traffic carried by the loop, rate-of-return LECs are required to recover a portion of those costs through traffic-sensitive carrier common line (CCL) charges imposed on IXCs. Part 69 also mandates per-minute charges for local switching even though a significant portion of local switching costs is associated with ports and appears to be driven by the number of lines or trunks connected to the switch, not by the number of minutes of traffic routed by the switch. Rather than fostering efficient pricing and competition, these mandatory rate structures applicable to rate-of-return LECs inflate usage charges and reduce charges for connection to the network, in essence overcharging high-volume end users in order to reduce rates for low-volume end users.

12. Although these inefficient rate structures might have been sustainable in a local monopoly environment, the introduction of competition from providers operating their own network facilities or leasing network facilities as unbundled network elements may undermine these access rate structures. While the entry of competitors in many rate-of-return LEC service areas may be delayed due to the provisions of section 251(f), entry in these areas will likely occur in time. A competing provider of exchange access services entering a market can use its own facilities, lease unbundled network elements, if permitted, or use special access services of the incumbent LEC to target selectively the incumbent LEC's high-volume end users with efficiently-priced access service offerings. This places the rate-of-return LEC at a regulatorily-imposed disadvantage in competing for the interstate access service associated with high-volume end users, and jeopardizes the source of revenue that permits the rate-of-return LEC to cover its costs of providing service to low-volume end users. At the same time, these inefficient rate structures and implicit support flows create artificial impediments to any new entrants that might seek to serve the subsidized end users, because they must attempt to do so without the benefit of a subsidy. As a result, these access rate structures may inhibit the development of competition in providing access service to low-volume end users.

13. In Section I.B.2, we describe some of the operating characteristics of rate-of-return LECs and the regulatory measures that are in place today to assist such companies. In Section II, below, we outline and seek comment on the revisions we propose to the switched access rate structure for rate-of-return LECs. These proposed revisions affect common line, local switching, transport, the transport interconnection charge, and signalling system-7 (SS7) services. In Section III, we seek comment on some additional issues relating to the regulation of interstate access services of rate-of-return LECs. These include the reallocation of general support facility (GSF) costs to nonregulated billing and collection service, the treatment of marketing expenses, the proposed assessment of a presubscribed interexchange carrier charge (PICC) on interstate special access lines, and the streamlining of the procedures for introducing rate elements other than those required by the access charge rules.

¹⁶ E.g. *Amendment of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture*, CC Docket No. 89-79, Report and Order & Order on Further Reconsideration & Supplemental Notice of Proposed Rulemaking, 6 FCC Rcd 4524, 4533 ¶ 50 (1991).

2. Rate-of-Return Overview

14. As we begin the process of access reform for rate-of-return LECs, it may be useful to identify some of the characteristics of rate-of-return LECs. They are not, however, a homogenous group, and their operating conditions vary significantly.

15. The largest rate-of-return LEC serves approximately one million access lines,¹⁷ while the smallest ones serve only a few hundred lines. Rate-of-return LECs serve fewer than eight percent of the total access lines in the country, accounting for approximately nine percent of the revenues.¹⁸ Some rate-of-return LECs receive more than 50 percent of their total revenues from interstate access revenues and universal service support, compared to just over 25 percent for LECs subject to price cap regulation. Many of these rate-of-return LECs serve rural areas, while others may serve suburban areas. Some of the larger rate-of-return LECs may serve both types of communities. They may be concentrated in one area, or may have operations in several states.

16. Rate-of-return LECs often have costs that are higher than those of their price cap brethren. Because they often serve areas that are less densely populated -- especially in rural areas -- they have longer loops and trunking facilities that increase their costs. They may also have higher installation costs due to difficult terrain. In addition, because rate-of-return LECs often serve smaller populations, they are not able to achieve the same economies of scale that larger carriers are able to achieve. In many instances, these LECs receive much of their revenue from one, or just a few, multi-line businesses in their service territory.

17. Rate-of-return LECs may file tariffs based on their own costs, or they may participate in the pooled National Exchange Carrier Association (NECA) common line or traffic sensitive tariffs. Participants in the NECA pools charge rates set by NECA tariffs and recover their costs, including a return on their investment. Some NECA pool members are compensated on the basis of "average schedules" rather than cost. Average schedule recovery reduces the cost to small rate-of-return LECs of conducting separate cost studies by providing compensation based on cost estimates derived from comparable cost companies.

18. Technological advances in the long distance world have created a situation in which distance is much less significant than it has been historically. This means that as long distance prices drop, companies that are heavy users of long distance services are free to locate in rural and suburban areas, stimulating economic growth in those areas.

19. Over the years, the Commission has addressed the cost of serving high-cost areas in a variety of ways. For example, the Commission has allocated more costs than might be reflected by relative use alone to the interstate jurisdiction through the separations process. Allowing incumbent LECs with high-cost loops to assign these additional costs to the interstate jurisdiction has kept local rates lower than they otherwise would have been. Through December 31, 1997, this form of high-cost support was recovered from the larger IXC's directly through a per-line charge. Additional switching

¹⁷ At the end of 1996, Puerto Rico Telephone Company had 1.188 million subscriber lines. See Universal Service Fund Data Collection, CC Docket No. 80-286, Universal Service Fund 1996 Submission of 1995 Study Results by NECA, Oct. 1, 1996.

¹⁸ *Id.*

costs of certain smaller incumbent LECs were also assigned to the interstate jurisdiction through the weighting of DEM.¹⁹ Through December 31, 1997, these switching costs were recovered through interstate access charges. These mechanisms were replaced on January 1, 1998, by the universal service mechanisms established pursuant to section 254 of the 1996 Act.²⁰

20. The Commission also kept the CCL rates charged by NECA common line pool members (many of which are high-cost companies) at levels that reflected what would have been the nationally averaged CCL rate if all incumbent LECs had been required to remain in the common line pool.²¹ This program was known as long term support. Through December 31, 1997, the support for this program came from the incumbent LECs that left the NECA common line pool. This funding method was replaced by universal service support on January 1, 1998.

21. Finally, rural rate-of-return LECs and their customers also benefit from other policies. The universal service system will ensure that these carriers and customers are protected from undue rate increases. In addition, rural customers are protected by section 254(g) of the 1996 Act, which requires long-distance carriers to average their interstate toll rates.²² Rural subscribers thus do not bear the full burden of the high cost of telephone access in rural areas.

II. RATE STRUCTURE MODIFICATIONS

A. Overview

22. In this section we propose to modify the switched access charge rules for rate-of-return LECs. We propose to adopt modifications similar to the ones we adopted for price cap LECs in our *Access Charge Reform Order*, unless differences in the market conditions or regulatory paradigms applicable to rate-of-return LECs and price cap LECs require different approaches to realize the underlying public interest objectives of access reform. We seek comment on rate structure rule changes for common line, local switching, and transport. We also seek comment on a proposal to phase out the transport interconnection charge, and on establishing rate structure rules for SS7 signalling services.

B. Common Line

1. Background

23. Common line (or loop) costs are the costs associated with the line connecting the end user's home or business with the LEC central office serving that premise. The costs of the loop are

¹⁹ The jurisdictional separations process allocates local switching costs between the state and interstate jurisdictions on the basis of relative DEM. Until December 31, 1997, study areas with fewer than 50,000 lines received support from DEM weighting, which shifts additional local switching costs to the interstate jurisdiction by multiplying the carrier's interstate DEM by a factor as high as 3.0.

²⁰ See *Universal Service Order*, 12 FCC Rcd at 8813.

²¹ See *id.*, 12 FCC Rcd at 9164-66.

²² 47 U.S.C. § 254(g).

divided between the intrastate and interstate jurisdictions, with 25 percent of the costs assigned to the interstate jurisdiction.²³ The costs associated with providing the common line between the end user's premises and the LEC central office are NTS because they do not vary with the amount of usage, or minutes passing over the loop.²⁴ In the original *Access Charge Order*, the Commission found that recovering NTS costs through flat monthly charges imposed on end users by incumbent LECs would promote optimal utilization of telecommunications facilities.²⁵ The Commission decided at that time, however, to limit the amount that could be recovered directly from the end user through end user common line (EUCL) charges, also called subscriber line charges (SLCs).²⁶ Rate-of-return LECs' SLCs are limited to recovering the lesser of the actual cost of the interstate portion of the local loop, or \$3.50 per month for residential and single line business customers, or \$6.00 per month for multi-line business customers.²⁷ These SLC ceilings do not permit most LECs subject to rate-of-return regulation to recover their interstate-allocated common line costs through flat charges. The remaining common line costs are recovered through CCL charges, which are per-minute charges imposed on IXCs.²⁸

24. The current CCL charge has been uniformly criticized by both incumbent LECs and IXCs because it discourages efficient use of the switched network and encourages customers to bypass the switched network for uneconomical reasons. The CCL charge is economically inefficient because it requires the LECs to recover a portion of their NTS costs through usage-sensitive charges. The IXCs, in turn, recover most or all of these costs from toll users in the form of per-minute charges, keeping toll rates artificially high and discouraging demand for interstate long distance services. High per-minute toll charges create support flows between different classes of customers. For example, low-volume toll users may not pay the full cost of their loops while high-volume toll users may contribute far more than the total cost of their loops. High-volume toll users, who include significant numbers of

²³ Through December 31, 1997, incumbent LECs with loop costs that exceeded 115% of the national average recovered a higher percentage of loop costs from the federal jurisdiction through a High Cost Fund that was funded entirely by IXCs based on the number of presubscribed lines. Beginning January 1, 1998, these costs are recovered through the new universal service support mechanisms. *Universal Service Order* at Sections VII and XIII.

²⁴ See, e.g., *Access Charge Reform Order*, 12 FCC Rcd at 15990-15996 ¶¶ 17-31; *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, 5 FCC Rcd 6786, 6793 (1990) (*LEC Price Cap Order*); Erratum, 5 FCC Rcd 7664 (Com. Car. Bur. 1990); *modified on recon.*, 6 FCC Rcd 2637 (1991) (*LEC Price Cap Reconsideration Order*); *aff'd sub nom. National Rural Telecom Ass'n v. FCC*, 988 F. 2d 174 (D.C. Cir. 1993).

²⁵ *MTS and WATS Market Structure*, CC Docket No. 78-72, Third Report and Order, 93 FCC 2d 241, 279 (1983) (*Access Charge Order*); *modified*, 97 F.C.C. 2d 682 (1983); *further modified*, 92 F.C.C. 2d 834 (1984), *aff'd in principal part and remanded in part sub nom. NARUC v. FCC*, 737 F.2d 1095 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 1227 (1985).

²⁶ *Access Charge Order*, 93 F.C.C. 2d at 284.

²⁷ See 47 C.F.R. § 69.104.

²⁸ See 47 C.F.R. § 69.105.

low-income customers, effectively support low-volume residential and multi-line business customers.²⁹ The rate structure currently in place for rate-of-return LECs, therefore, creates support flows between different classes of service and customers.

25. In addition, these implicit subsidies are economically inefficient. Without modifications to the current rate structure, new entrants, which are not subject to these rate structure requirements, would be in a position to target the access traffic of incumbent LECs' most profitable, high-volume end users based on regulatory requirements. A loss of profitable end users would increase the incumbent LECs' costs of providing access service to the rest of their end users.

2. Discussion

a. General

26. Modifications Adopted for Price Cap LECs. In the *Access Charge Reform Order*, the Commission directed price cap LECs to recover more of their common line NTS revenues directly from the end user by increasing the ceilings on SLCs for non-primary residential and multi-line business lines. For primary residential and single-line business lines, however, the Commission declined to increase the SLC ceiling above its existing \$3.50 level because an increase in the SLC for these lines might make basic telecommunication service unaffordable for some consumers.³⁰ The Commission concluded, however, that these universal service concerns were not as great for non-primary residential and multi-line business lines, and, accordingly, adjusted the SLC ceilings on these lines to allow price cap LECs to recover more of their common line costs directly from the end users.³¹ Specifically, the Commission permitted price cap LECs to adjust their SLC ceilings on non-primary residential and multi-line business lines to the level necessary to recover their average per-line interstate-allocated common line costs,³² subject to an inflation-adjusted \$9.00 ceiling.³³ The Commission stated that although there might be some disparity between the average SLCs in low- and high-cost areas, the \$9.00 SLC ceiling would ensure that SLCs in high-cost areas would be "reasonably comparable" to SLCs in urban areas.³⁴

²⁹ See Robert W. Crandall, *Universal Service Subsidies and Consumer Welfare: Long-distance Access Charges*, Brookings Institution (April, 1997), Table 1 (showing that roughly 30 percent of households with income under \$10,000 spend more on long-distance calls than do 50 percent of the households with income over \$75,000).

³⁰ *Access Charge Reform Order*, 12 FCC Rcd at 16010-16011 ¶ 73.

³¹ *Id.*, 12 FCC Rcd at 16011-16018 ¶¶ 74-87.

³² When the maximum presubscribed interexchange carrier charge (PICC) assessed on primary residential lines, plus the maximum SLC on those lines, recovers the full amount of a price cap carrier's per-line common line price cap revenues, the carrier will base its SLC calculation on the average per-line common line revenues permitted under the price cap rules. *Access Charge Reform*, CC Docket No. 96-262, Order on Reconsideration, 12 FCC Rcd 10119 (1997).

³³ *Access Charge Reform Order*, 12 FCC Rcd at 16013-16014 ¶¶ 77-78. For multi-line business lines, the SLC was adjusted to recover the average per-line interstate-allocated common line costs beginning July 1, 1997.

³⁴ *Id.*, 12 FCC Rcd at 16014-16016 ¶¶ 79-83.

27. To ameliorate any possible adverse impact of an immediate SLC adjustment for non-primary residential lines, the Commission phased in adjustments in the SLC ceilings for these lines. On January 1, 1998, the monthly SLC for customers of price cap LECs was adjusted to the incumbent LEC's average per-line interstate-allocated costs, but may not exceed \$1.50 more than the current SLC ceiling.³⁵ Annually thereafter, the monthly SLC ceiling for these lines will be adjusted for inflation and will increase by \$1.00 per line, until the SLC ceiling for non-primary residential lines is equal to the ceiling permitted for multi-line business lines.³⁶

28. In addition to adjusting the SLC ceiling for non-primary residential and multi-line business lines, the Commission adopted other common line rate structure modifications in the *Access Charge Reform Order* that will permit price cap LECs to transition, in a relatively short period of time, from a cost-recovery mechanism that recovers a significant portion of NTS common line costs through per-minute CCL charges to one that recovers these costs through flat-rated charges.³⁷ To the extent that SLC ceilings prevent price cap LECs from recovering their allowed common line revenues from end users, these LECs will recover the shortfall, subject to a maximum charge, through a presubscribed interexchange carrier charge (PICC). The PICC is a flat, per-line charge assessed on the end-user's presubscribed interexchange carrier.³⁸

29. The PICC, which over time will shift revenue recovery from the per-minute CCL charges to a flat-rated charge, was designed to allow price cap LECs to recover the difference between revenues collected through the SLCs and the total revenue permitted for the common line basket. In order to provide price cap LECs and IXC's with adequate time to adjust to the new rate structure, the Commission adopted an approach that will gradually phase in the PICC over time. Specifically, effective January 1, 1998, PICCs for primary residential and single-line business lines are capped at \$0.53 per month for the first year.³⁹ Beginning January 1, 1999, the ceiling on the monthly PICC on primary residential and single-line business lines will be adjusted for inflation and will increase by \$0.50 per year until it equals one twelfth of the sum of the annual per-line common line revenues and residual interconnection charge revenues permitted under our price cap rules divided by the projected average number of local exchange service subscriber lines in use during such annual period, less the maximum primary residential and single-line business lines SLC computed pursuant to our rules.⁴⁰

30. In addition, to the extent that the SLC ceilings on all lines and the PICC ceilings on primary residential and single-line business lines prevent recovery of the full common line revenues permitted by the price cap rules, the new rate structure permits price cap LECs to recover the shortfall

³⁵ *Id.*, 12 FCC Rcd at 16014 ¶ 78.

³⁶ *Id.*

³⁷ *Id.*, 12 FCC Rcd at 16018-16026 ¶¶ 88-105

³⁸ *Id.*

³⁹ *Id.*, 12 FCC Rcd at 16020-16021 ¶ 94.

⁴⁰ *Id.*; see also 47 C.F.R. § 69.153(c); *Access Charge Reform*, CC Docket No. 96-262, Second Order on Reconsideration and Memorandum Opinion and Order, 12 FCC Rcd 16606 (1997).

through a flat-rated, per-line PICC on non-primary residential and multi-line business lines.⁴¹ For the first year, the ceiling on the PICC will be \$1.50 per month for non-primary residential lines and \$2.75 per month for multi-line business lines.⁴²

31. Beginning January 1, 1999, the PICC for price cap non-primary residential and multi-line business lines will be adjusted for inflation and will increase by a maximum of \$1.00 and \$1.50 per year, respectively, until price cap LECs recover all their permitted common line revenues through a combination of flat-rated SLC and PICCs.⁴³ As the PICC ceilings on primary residential and single-line business lines increase, the residual per-minute CCL charge will decrease until it is eliminated. After the residual per-minute CCL and residual TIC are eliminated, and as the PICC ceilings for primary residential and single-line business lines increase, price cap LECs will reduce their PICCs on non-primary residential and multi-line business lines by an amount that corresponds to the total increases in PICCs for primary residential and single-line business lines.⁴⁴ Reductions will be targeted to the PICCs on multi-line business lines until the PICCs for those lines are equal to the PICCs for non-primary residential lines. Thereafter, price cap LECs will apply the annual reductions to both classes of customers equally until the combined SLCs and PICCs for primary residential and single-line business lines recover the full average per-line common line revenues permitted under our price cap rules, and the additional PICCs on non-primary residential and multi-line business lines no longer recover common line revenues.⁴⁵ In the *Second Reconsideration Order*, we limited the application of the PICC that applies to multi-line business Centrex lines to one-ninth of the PICC plus the difference between the \$9.00 SLC and the average interstate cost of the loop (if greater than \$9.00), subject to the PICC ceiling. Where customers do not designate a presubscribed interexchange carrier, price cap LECs may collect directly from the customer the PICC that could otherwise be assessed against the presubscribed interexchange carrier.⁴⁶

32. To the extent that PICCs do not recover an incumbent LEC's remaining permitted CCL revenues, price cap LECs will be allowed to recover any such residual common line revenues through per-minute CCL charges assessed on originating access minutes.⁴⁷ Price cap LECs may assess an originating CCL charge that, when added to the sum of local switching charges, the per-minute residual TIC, and any per-minute charges related to marketing expenses, does not exceed the sum of local switching charges, the per-minute CCL charge, and TIC assessed on originating minutes on

⁴¹ *Access Charge Reform Order*, 12 FCC Rcd at 16022 ¶ 99.

⁴² *Id.*

⁴³ *Id.*, 12 FCC Rcd at 16023 ¶ 101.

⁴⁴ *Id.*, 12 FCC Rcd at 16023-16024 ¶ 102.

⁴⁵ *Id.* As discussed in Sections II.D and III.B, the PICC will recover TIC revenues and certain marketing expenses in addition to common line revenues. Therefore, non-primary residential line and multi-line business PICCs may continue to recover non-common line revenues, even though SLCs and PICCs for primary residential and single-line business lines recover the average per-line common line revenues permitted under our price cap rules.

⁴⁶ *Id.*, 12 FCC Rcd at 16019-16020 ¶ 92.

⁴⁷ *Id.*, 12 FCC Rcd at 16022-16023 ¶ 100.

December 31, 1997. To the extent that the originating CCL rate does not recover all the CCL costs, price cap LECs may recover the shortfall through per-minute charges assessed on terminating minutes.⁴⁸

33. In the *Access Charge Reform Order*, we reassigned certain costs currently recovered through the TIC to specified facilities charges.⁴⁹ For price cap LECs, those costs that remain (the "residual TIC") are recovered through the PICC. To the extent that the PICC ceiling prevents recovery of the entire residual TIC, the remaining portion will be collected through a per-minute residual TIC. As the ceilings on the PICCs increase, a larger percentage of the residual TIC will be recovered through the PICC.⁵⁰ Beginning with the annual access tariffs that became effective July 1, 1997, price cap productivity reductions reflected in the "X-Factor minus GDP-PI" formula are targeted to the per-minute residual TIC until it is eliminated. For price cap LECs, the per-minute TIC charge should be eliminated in two to three years. As with the residual CCL charge, any residual per-minute TIC will be placed on originating minutes unless the ceilings prevent the price cap LEC from recovering the total TIC revenues permitted under our price cap rules.

34. In our *Universal Service Order*, we set in place rules that will identify and convert existing federal universal service support in the interstate high cost fund, the DEM weighting program, Long Term Support (LTS), Lifeline, Link Up, and interstate access charges, to explicit competitively neutral federal universal service support mechanisms for both rural and non-rural LECs.⁵¹ We stated that we will provide universal service support to non-rural LECs through a mechanism based on forward-looking economic costs beginning on January 1, 1999. Until the forward-looking mechanism takes effect on January 1, 1999, non-rural carriers will continue to receive high cost loop support at levels determined by existing universal service mechanisms.⁵² The existing high-cost support mechanisms for rural LECs will remain unchanged until January 1, 2001, at the earliest.

35. Applicability to Rate-of-Return LECs. We tentatively conclude that we should adopt rate structure modifications for rate-of-return LECs that are similar to those that were adopted for price cap

⁴⁸ *Id.* As discussed in Sections II.C, II.D, and III.B below, the residual TIC, certain switching costs, and marketing expenses will be recovered through a combination of SLCs and PICCs.

⁴⁹ *Id.*, 12 FCC Rcd at 16076-16078 ¶¶ 217-223. These specified cost reallocations from the TIC to other access elements include: (1) SS7 costs to local switching or signalling rate elements; (2) central office equipment maintenance expenses primarily to the local switching category; (3) host-remote link costs not recovered by the current tandem-switched transport rates to the tandem-switched transport rate element; (4) effect of using actual minutes rather than 9,000 minutes in deriving tandem-switched transport rates to tandem switched transport transmission elements; (5) tandem costs transitioned to the tandem switching element; (6) effects of transport rate deaveraging to direct-trunked transport or tandem-switched transport rate elements; (7) multiplexing and trunk port costs to the tandem switching element for rate-of-return LECs; and (8) residual amounts of price cap LECs to facilities-based rate elements pursuant to a transition mechanism.

⁵⁰ The PICC increases will first recover any residual CCL charge until it is eliminated. Once the CCL charge is eliminated, through increases in the SLCs and PICCs, the PICC will recover residual TIC costs. *Id.*, 12 FCC Rcd at 16023-16024 ¶ 102.

⁵¹ *Universal Service Order*, 12 FCC Rcd at 8903-8917 ¶¶ 232-251.

⁵² *Id.*, 12 FCC Rcd at 8909-8910 ¶ 245.

LECs in the *Access Charge Reform Order*. We conclude that similar modifications are needed to remove implicit subsidies and ensure that charges more accurately reflect the manner in which the costs are incurred, thereby promoting competition. We acknowledge that certain rate-of-return LECs, especially those in rural and insular areas, face different market conditions and incur higher costs than do many price cap LECs. Smaller LECs serving more costly areas, however, will receive universal service support based on their embedded costs until the Commission, with the Universal Service Joint Board's assistance, develops an appropriate model to ensure that rural carriers receive support at a level that will enable them to provide supported services at affordable rates.⁵³ We tentatively conclude, therefore, that adopting similar modifications to those adopted in the *Access Charge Reform Order*, along with universal service support provided through the new universal service mechanisms, is a significant step that will improve the efficiency of the rate structures employed by rate-of-return LECs.

36. We seek comment on the applicability of the rate structure modifications adopted for price cap LECs to rate-of-return LECs. We recognize that certain rate-of-return LECs face higher operating and equipment costs attributable to the lack of economies of scale that result from low subscriber density and small exchanges that characterize rural areas. Adopting the same approach for rate-of-return LECs, therefore, most likely will not align rates with costs as quickly as it will for price cap LECs. For many rate-of-return companies, especially those located in rural and insular areas, longer loops and difficult terrain result in average loop costs that significantly exceed the average loop costs of price cap LECs. NECA's average per-line interstate revenue requirement for 1997, for example, was more than \$10.00 per line, per month, compared with a monthly per-line average of \$6.10 for price cap LECs.⁵⁴ In addition, if we were to adopt the modifications described below that would direct rate-of-return LECs to recover certain switching, marketing, and residual transport interconnection costs through the common line SLCs and PICCs, per-line common line costs will increase further.⁵⁵

37. Several entities argue that, because of the high common line costs and smaller economies of scale, if we were to adopt the same rate structure modifications that were adopted for price cap LECs, the SLCs for many rate-of-return carriers' multi-line business lines would reach the \$9.00 ceiling immediately and would still not recover the average interstate-allocated common line costs for those lines.⁵⁶ Several entities have expressed concern that the immediate SLC increases to \$9.00 will create a large disparity between SLCs charged by rate-of-return LECs and neighboring price cap

⁵³ *Id.*, 12 FCC Rcd at 8918 ¶ 254.

⁵⁴ See *Supporting Material filed with 1996 Annual Access Tariff Filing, filed with Commission on April 2, 1996 (1996 LEC Annual Access Tariff Forecast Data)*.

⁵⁵ See Sections II.C (Local Switching), II.D (Transport and TIC), and III.B (Marketing Expenses) below.

⁵⁶ Effect of Price Cap Access Rules on NECA's Common Line Pool: NECA Model Descriptions and Assumptions at 3 (filed Dec. 5, 1997). NECA's calculations, which were submitted to the Common Carrier Bureau in response to a request for information, are based on several general assumptions, are informational, and do not represent NECA's position regarding how common line costs should be recovered. *Id.* at 2. See also United States Telephone Association (USTA) Data Assessing the Impact of Access Regulations for Price Cap Companies on Non-Price Cap LECs (filed Dec. 16, 1997).

LECs,⁵⁷ and that under the 1996 Act and applicable state laws, the lower-cost price cap carriers will be able to "cherry pick" the high volume business customers of the higher priced rate-of-return LECs. These entities urge the Commission to grant them pricing flexibility and propose that SLCs be set based on the national average or on the neighboring price cap LEC's average SLC.

38. A SLC ceiling that does not permit rate-of-return LECs to recover all of their interstate-allocated costs from end users would create a shortfall that would have to be recovered through the per-minute CCL charges or through an alternative recovery mechanism. The cost recovery mechanism for price cap LECs contemplates that price cap LECs will be able to recover all of their interstate-allocated common line costs through a combination of SLCs and PICCs, reducing the CCL charge to zero in a relatively short amount of time.⁵⁸ Indeed, we expect that for many of the price cap carriers, the CCL charge will be reduced to zero by the year 1999. The price-cap cost recovery mechanism also contemplates that the PICCs assessed on non-primary residential and multi-line business lines will be a short-term, temporary measure to recover residual common line costs until the SLCs and PICCs on primary residential and single-line business lines reach the level necessary to recover the per-line interstate-allocated common line costs for those lines.

39. If rate-of-return LECs were to implement the revised common line rate structure applied to price cap LECs, multi-line business PICCs and CCL charges would remain higher than those of price cap LECs for the foreseeable future, because rate-of-return LEC common line costs are significantly higher than those of price cap LECs. Under this scenario, the SLCs and/or PICCs for many rate-of-return LECs would have to be adjusted to a level that would be higher than the ceilings we adopted for price cap LECs if significant reductions in the CCL rate were desired. These points are illustrated by projections submitted by NECA and the United States Telephone Association (USTA). The data submitted by these parties show that implementing the same common line rate structure adopted for price cap LECs would result in the SLC for multi-line business customers reaching the \$9.00 ceiling immediately.⁵⁹ Moreover, while the PICCs for multi-line businesses and non-primary residential lines would begin to decrease for price cap LECs by 1999 and 2000 respectively, the NECA and USTA projections suggest that the multi-line business PICCs of rate-of-return LECs would reach \$7.07 and \$7.64, respectively, by the year 2001 and continue to grow beyond that date. USTA's data suggests that with the SLCs and PICCs at their caps, the CCL per minute rate in 1998 (including common line costs, line port costs, and marketing expenses) would be \$0.01 for originating minutes and \$0.024 for terminating minutes, assuming a \$0.01 ceiling on originating CCL rates (reflecting the existing requirement of section 69.106 of our rules). NECA's CCL calculation, which includes the residual TIC

⁵⁷ *Id.*

⁵⁸ In some cases the \$9.00 SLC on non-primary residential and multi-line business lines will not recover all common line costs, including marketing and TIC costs recovered through the common line rate elements. In such cases the LECs may continue to assess a PICC on these lines to recover these residual costs.

⁵⁹ Effect of Price Cap Access Rules on NECA's Common Line Pool: NECA Model Descriptions and Assumptions at 3. NECA's calculations, which were submitted to the Common Carrier Bureau in response to a request for information, are based on several general assumptions, are informational, and do not represent NECA's position regarding how common line costs should be recovered. *Id.* at 2. See also USTA Data Assessing the Impact of Access Regulations for Price Cap Companies on Non-Price Cap LECs.

costs in addition to the three costs used by USTA, suggests that the CCL per minute rate would be \$0.0230 in 1998, if assessed equally on both originating and terminating minutes.⁶⁰

40. In light of the apparent disparities that may be created by applying the same SLC and PICC ceilings to rate-of-return LECs that were adopted for price cap LECs, we ask interested parties to discuss how we should determine appropriate SLC ceilings. For example, should we adopt a ceiling that is based on the neighboring price cap LEC's average multi-line business SLC, or on the national average? In addition, in some cases, as the non-primary SLC cap increases, the disparity between the \$3.50 SLC for primary residential lines and the SLC for non-primary residential lines will most likely be greater for rate-of-return carriers than it is for price cap companies. Would this disparity warrant a different approach for rate-of-return carriers' non-primary residential lines than we adopted for price cap LECs?

41. Interested parties should discuss whether the PICC is an effective cost recovery mechanism for rate-of-return LECs' common line costs and, if so, to what extent the PICCs and CCL charges for rate-of-return LECs should be comparable to those of price cap LECs. If commenters believe that the plan we adopted in the *Access Charge Reform Order* would not produce the expected economic benefits for rate-of-return LECs and their customers, interested parties should submit alternative plans. For example, should we prescribe higher ceilings for PICCs that would permit rate-of-return LECs to reduce their CCL rates to levels comparable to those of price cap LECs? Alternatively, should we prescribe a maximum CCL charge and eliminate the PICC ceiling to allow rate-of-return LECs to recover the shortfall through flat-rated charges? In addition, in light of the higher common line costs incurred by many rate-of-return LECs, and because, if adopted, other modifications proposed below will require rate-of-return LECs to recover certain switching, marketing, and TIC costs through the common line recovery mechanism, we invite parties to discuss whether we should permit these carriers to recover relatively more of the common line revenue requirement through terminating minutes. Given that local switching per-minute rates will be reduced significantly by the inclusion of DEM weighting in universal service support, we ask interested parties to discuss whether a higher per-minute CCL charge in the short run is unsatisfactory.

42. Interested parties should also discuss the extent to which, for purposes of assessing SLCs and PICCs, residential and business lines should be treated differently. For example, should non-primary residential lines be assessed lower PICCs than multi-line business lines and phased in over time as we did for price cap LECs, or should we permit the SLCs for non-primary residential lines to increase more rapidly than for price cap LECs in order to allow carriers in high-cost areas to reduce their CCL charge more rapidly than would otherwise be possible with phased-in SLC increases? Alternatively, should a uniform PICC be applied to all non-primary residential and business lines to spread the revenue requirement evenly across these classes of customers?

43. In our recent *Access Charge Reform Second Order on Reconsideration*, we concluded that with respect to the PICC, Centrex customers should be treated similarly to PBX customers, because the two arrangements are functionally equivalent. Accordingly, we granted petitions by USTA, International Communications Association (ICA), and the County of Los Angeles that Centrex lines be

⁶⁰ The USTA and NECA data project CCL rates that would result using their assumptions. We note that our proposal for rate-of-return LECs recovers costs first through originating CCL rates, subject to a ceiling, after which terminating traffic is assessed to recover any residual.

assessed PICCs using a line-to-trunk equivalency ratio.⁶¹ We adopted a 9:1 line-to-trunk ratio based on data provided by USTA because we found the 9:1 ratio to be reasonable and administratively simple.⁶² We limited the PICC charges that may be assessed on IXC's serving Centrex customers to a line-to-trunk equivalency basis except where the multi-line business SLC ceiling does not permit the recovery of all interstate-allocated loop costs from the end user. In those instances, a somewhat greater PICC -- one that includes the difference between the per-line loop cost and the multi-line business SLC cap -- will be assessed on Centrex lines.⁶³ We seek comment on the applicability of this approach and of the 9:1 ratio to rate-of-return LECs. Parties proposing different ratios should submit data supporting the ratio they propose.

44. We also seek comment on how the 1996 Act will affect the development of competition in areas served by small and rural rate-of-return LECs. Specifically, section 251(f)(1) provides an exemption for certain rural telephone companies from the duties of local exchange carriers enumerated in section 251(c), including but not limited to, the duties to interconnect, to provide access to network elements on an unbundled basis, and to resell telecommunications services.⁶⁴ Section 251(f)(2) provides a mechanism by which local exchange carriers with fewer than two percent of the nation's subscriber lines may petition the state for suspension or modification of some of the duties imposed by the Act on local exchange carriers.⁶⁵ We ask interested parties to discuss the impact of these sections and the development of competition as they relate to the rate structure and transition mechanism we are proposing.⁶⁶

45. We also seek comment on whether we should adopt one approach for all rate-of-return LECs or whether our approach should vary depending on size, population density, topography, or other factors that may vary among rate-of-return LECs. Are there concerns that are specific to NECA pooling companies that warrant separate treatment? Interested parties should address the specific issues raised and submit proposals for modifications that are consistent with the goals of the 1996 Act. Interested parties should also propose a time frame for adopting modifications to the rate structure. Should modifications adopted become effective immediately or should they be phased in over time? Finally, parties should address the extent to which options proposed affect small business entities, including small incumbent LECs and new entrants.⁶⁷

⁶¹ USTA Petition at 2-4; ICA Petition at 2-5; Los Angeles Petition at 1-11.

⁶² *Access Charge Reform*, CC Docket No. 96-262, Second Order on Reconsideration and Memorandum Opinion and Order, 12 FCC Rcd 16606, 16617-18 ¶ 38 (1997).

⁶³ *Id.*, 12 FCC Rcd at 16617 ¶ 36.

⁶⁴ 47 U.S.C. § 251(f)(1).

⁶⁵ 47 U.S.C. § 251(f)(2).

⁶⁶ We note that the U.S. Court of Appeals for the Eighth Circuit has ruled that state commissions have the exclusive authority to determine whether to continue or terminate an exemption under subsection 251(f). *Iowa Utils. Bd. v. FCC*, 120 F.3d at 801.

⁶⁷ See Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

b. Assessment of SLCs and PICCs on Derived Channels

46. Modifications Adopted for Price Cap LECs. The *Access Charge Reform Order* established separate SLC rates for integrated services digital network (ISDN) service based on the NTS loop costs of Basic Rate Interface (BRI) and Primary Rate Interface (PRI) ISDN service. Based on the record, which indicated that the NTS loop costs of PRI ISDN service, excluding switching costs, reflect a cost ratio of approximately 5:1 compared to the NTS loop costs of single-channel analog service, the Commission established, effective July 1, 1997, a SLC rate for PRI ISDN service equal to five times the incumbent LEC's multi-line business SLC. Similarly, because the record showed that the NTS loop costs of BRI ISDN service, excluding NTS switching costs, when rounded to the nearest half SLC, reflect a 1:1 cost ratio relative to the NTS loop costs of single-channel analog service, the Commission set a SLC rate for BRI ISDN service equal to the price cap LEC's non-primary residential line SLC.⁶⁸

47. Data submitted by the Bell Operating Companies (BOCs) in response to the 1995 ISDN SLC NPRM⁶⁹ indicated that line cards and trunk cards for PRI ISDN service in particular constitute a significant portion of the total NTS costs that are dedicated to the provision of service to the subscriber, and that ISDN line cards and trunk cards are many times more expensive than the cards used for standard analog service. We therefore directed price cap LECs to recover the difference between the cost of an ISDN line card and the cost of a line card used for basic, analog service through a separate charge assessed directly on ISDN end users.⁷⁰ Price cap LECs are also permitted to assess one PICC for BRI ISDN service and five PICCs for PRI ISDN service. The PICCs assessed on these lines are subject to the same ceilings and increases imposed on non-primary residential and multi-line business lines discussed above.⁷¹ The *Access Charge Reform Order* limited these provisions to BRI and PRI ISDN service because the record did not contain sufficient information to enable the Commission to determine the relative NTS costs of other derived channel services.⁷²

48. Applicability to Rate-of-Return LECs. We propose to adopt similar SLCs and PICCs for ISDN service offered by rate-of-return LECs. We seek comment on this conclusion and invite parties to comment on the impact that assessing SLCs and PICCs on ISDN lines will have on rate-of-return carriers and their customers. Parties should address whether the cost relationship between ISDN and analog service provided by rate-of-return LECs is similar to that of price cap LECs; if they believe it is not, they should submit specific data supporting their position. We recognize that our treatment of ISDN lines will depend on the other common line rate structure modifications discussed above. We therefore invite parties to discuss the relationship between proposed modifications to the common line rate structure and our tentative conclusion to treat rate-of-return LECs' ISDN lines in the manner discussed above.

⁶⁸ *Access Charge Reform Order*, 12 FCC Rcd at 16032 ¶ 116.

⁶⁹ *End User Common Line Charges*, CC Docket No. 95-72, Notice of Proposed Rulemaking, 10 FCC Rcd 8565 (1995).

⁷⁰ *Access Charge Reform Order*, 12 FCC Rcd at 16032-33 at ¶ 117.

⁷¹ *Id.* at ¶¶ 118-119.

⁷² *Id.* at ¶ 120.

C. Local Switching

1. Background

49. The local switch connects subscriber lines both with other local subscriber lines and with dedicated and shared interoffice trunks. Local switching costs include the costs of analog or digital switching systems and the costs of line ports and trunk ports that connect subscriber lines and interoffice trunks, respectively, to the switch. The interstate portion of these costs is currently recovered through per-minute local switching charges levied on IXC's.⁷³

50. The jurisdictional separations process currently allocates local switching costs between the state and interstate jurisdictions on the basis of relative DEM. Smaller incumbent LECs are able to charge lower prices for intrastate services because DEM weighting permits such LECs to assign intrastate switching costs to the interstate jurisdiction. This cost assignment is accomplished by multiplying the qualifying carrier's interstate DEM by a maximum factor of 3.0. Through December 31, 1997, these weighted local switching costs were recovered from IXC's through per-minute access charges for use of the local switch. Since January 1, 1998, rural carriers recover from the new universal service support mechanisms a subsidy corresponding in amount to that generated formerly by DEM weighting.⁷⁴ A rate-of-return LEC must exclude from its local switching interstate revenue requirement any high-cost support attributable to DEM weighting.⁷⁵

2. Discussion

a. Dedicated Facilities

51. Modifications Adopted for Price Cap LECs. In the *Access Charge Reform Order*, the Commission found that a portion of the costs of the local switch do not vary with the level of traffic at the switch, but instead are related to the number of lines or trunks associated with the switch. The Commission concluded that when a line-side port is dedicated to a single customer or IXC, the cost recovery mechanism should be through a flat-rated charge on that customer or carrier. The Commission also required price cap LECs to assess a flat-rated trunk port charge on the purchaser of the dedicated trunk terminating at the port.⁷⁶ The Commission created a separate, traffic-sensitive rate element for shared trunk ports. Accordingly, the Commission directed that costs associated with line-side ports be removed from the local switching charge and be recovered through common line rates.⁷⁷

⁷³ *Access Charge Reform Order*, 12 FCC Rcd at 16114-16117 ¶¶ 304-07.

⁷⁴ The definition of rural carrier is provided at 47 U.S.C. § 153(37).

⁷⁵ *Access Charge Reform*, Order on Reconsideration, 12 FCC Rcd 10119 ¶ 5 (1997).

⁷⁶ As used in this notice, the term "line port" or "line-side port" includes the line card, protector, and main distribution frame.

⁷⁷ In the *Access Charge Reform Order*, we found that it would be inconsistent with a Joint Board recommendation if we were to mandate, at this time, recovery of NTS local switching costs directly from universal service support mechanisms. *Access Charge Reform Order*, 12 FCC Rcd at 16038-16039 ¶ 132. Thus, we rejected proposals to recover the entire NTS portion of local switching costs from the new universal service support mechanisms. *Id.* We will not revisit this issue in this proceeding.

52. Common line charges will recover the cost of a line port used to provide basic, analog service, even when the end user has another form of service. For some services, such as ISDN, the cost of a line port is significantly more than the cost of a line port associated with a basic, analog line. Price cap LECs may assess a monthly flat-rated charge directly on end users of such services to recover the additional line port costs associated with those services.

53. The Commission required price cap LECs to conduct cost studies to determine separately the geographically-averaged portion of local switching costs that is attributable to line-side ports and dedicated trunk-side ports to support the port rates in their access tariffs. In addition, the Commission decided that the costs of DS1/voice-grade multiplexing associated with analog local switches should be recovered through the newly-created trunk port rate elements within the traffic sensitive basket.⁷⁸

54. Applicability to Rate-of-Return LECs. We propose to require rate-of-return LECs to reassign all costs for line-side ports from the local switching category to the common line category. These costs would then be recovered through the rate structure adopted in response to our proposals in Section II.B, above. We seek comment on this proposal. We ask if there are any specific factors for rate-of-return LECs that would preclude our adoption of this rate structure change at this time. In addition, we propose to require rate-of-return LECs to conduct cost studies to determine the geographically-averaged portion of local switching costs that is attributable to the line-side ports and to trunk side ports, to be filed with the tariffs implementing these changes. We solicit comment on this cost study proposal. In the alternative, commenters are requested to suggest a substitute mechanism to identify and assign costs to line-side ports or to trunk-side ports.

55. We propose to require rate-of-return LECs to recover dedicated trunk port costs through a flat-rated trunk port charge assessed on the purchaser of the dedicated trunk terminating at the port. We also propose to establish a separate rate element through which rate-of-return LECs can recover on a flat-rated basis the additional costs of DS1/voice grade multiplexers required in conjunction with terminating dedicated trunks at analog switches that were reassigned from the TIC.⁷⁹ We ask whether the benefits to be gained from a more efficient, cost-causative rate structure outweigh the burden on rate-of-return LECs of establishing these new rate elements. In addition, we solicit suggestions as to what specific modifications of the Part 69 cost allocation rules we should make to implement any rate structure changes for dedicated local switching facilities.

56. For rate-of-return LECs, we propose to permit a separate, monthly, flat-rated, end-user charge to recover the amount by which the cost of a line port for ISDN, or the cost of a line port associated with other services, exceeds the cost of a line port for basic, analog service. We request comment on this proposal.

⁷⁸ Analog switches require a voice-grade interface on the trunk-side of the end office switch, thereby requiring DS1 transport trunks to be demultiplexed into individual voice-grade circuits before being switched at analog end office switches. DS1/voice-grade multiplexers perform this function. A digital switch port includes the DS1/voice-grade multiplexing function.

⁷⁹ *Access Charge Reform*, Order on Reconsideration, 12 FCC Rcd 10119 (1997).

b. Shared Facilities

57. Modifications Adopted for Price Cap LECs. The *Access Charge Reform Order* required price cap LECs to recover the costs of shared local switching facilities, including the central processing unit, switching matrix, and shared trunk ports, on a per-minute basis, due to the difficulty in identifying the NTS and traffic-sensitive (TS) portions of the costs of these shared switching facilities, together with the companion difficulty in verifying the accuracy of incumbent LEC studies attempting to make this identification.⁸⁰ In addition, the Commission established an optional per message call setup charge,⁸¹ concluding that the collection of a call setup charge should not be mandatory in cases where the price cap LEC determines that the costs of doing so exceed the benefits of establishing such a charge.⁸² The Commission stipulated that a price cap LEC choosing to impose a call setup charge may not include in that charge any costs that it recovers through other local switching charges, through charges for dedicated SS7 facilities, or through other signalling charges.⁸³

58. Applicability to Rate-of-Return LECs. In conformance with the decision reached in the *Access Charge Reform Order*,⁸⁴ we tentatively conclude that we will adhere to a per-minute rate structure for shared local switching facilities of rate-of-return LECs. Under this approach, the shared trunk ports and any associated DS1/voice grade multiplexers required at analog local switches will be assessed on a per-minute basis, separate from the charge for the switch itself. We seek comment on this tentative conclusion. In particular, we ask whether there are any factors inherent to rate-of-return LECs that should lead us to change this tentative conclusion.

59. We propose to permit, but not require, rate-of-return LECs to establish a call setup charge. Under this proposed revision to Section 69.106, a rate-of-return LEC could elect to establish a separate per-call setup charge assessed on IXC's for all originating interstate calls handed off to the IXC's POP, and on all terminating interstate calls that are received from an IXC's POP, whether or not a call is completed, because at this point the rate-of-return LEC's switches and signalling network have performed their functions and the incumbent LEC has incurred the full cost of its call setup function. We invite comment on this proposal for an optional call setup charge, including specific language to modify our Part 69 cost allocation rules to implement this rate structure change. Moreover, if a rate-of-return LEC elects to recover revenue requirements through a call setup charge, we tentatively conclude that this charge cannot overlap with any other local switching charges, with charges for dedicated SS7 facilities, or with other signalling charges. We request comment on our tentative conclusion prohibiting double recovery for call setup charges by rate-of-return LECs. Commenters also should suggest mechanisms that would prevent any double recovery for rate-of-return LECs.

⁸⁰ *Access Charge Reform Order*, 12 FCC Rcd at 16040 ¶ 135.

⁸¹ Call setup is the process of establishing a transmission path over which a phone call will be routed. As explained with regard to price cap LECs, call setup costs using SS7 are incurred primarily on a per-call rather than a per-minute basis.

⁸² *Access Charge Reform Order*, 12 FCC Rcd at 16042 ¶¶ 138-39.

⁸³ *Id.*, 12 FCC Rcd at 16046 ¶ 147.

⁸⁴ *Id.*, 12 FCC Rcd at 16040 ¶ 135.

60. As stated in the *Access Charge Reform Order*, it would be extremely difficult to segregate the costs of the switch central processing unit and other traffic-sensitive costs into per-message and per-minute portions and to verify that the allocation has been done properly. Therefore, we propose to limit the costs that a rate-of-return LEC may recover through call setup charges to those associated with signalling. We request comment on this proposal to limit cost recovery to signalling. We seek comment on how call setup costs are affected by whether multifrequency (MF) signalling or SS7 signalling is employed. We also request estimates of the percentage of the total costs of a typical call that are represented by call setup costs.⁸⁵

D. Transport Services and the Transport Interconnection Charge (TIC)

1. Background

61. Transport services carry interstate switched access traffic between the IXC's POP and the incumbent LEC end office that serves the end user customer. Transport charges are assessed for entrance facilities, direct-trunked transport, tandem-switched transport, and the TIC. We describe the pricing principles for the various segments below, including those changes adopted in the *Access Charge Reform Order* that are already applicable to rate-of-return LECs. In this section, we consider the remaining transport and TIC issues applicable to rate-of-return LECs.

62. Entrance facilities are dedicated LEC transmission facilities that carry interstate traffic between an IXC's POP and the LEC end office serving the POP (called the serving wire center or (SWC)). Direct-trunked transport facilities are dedicated trunks that carry an IXC's traffic from the LEC end office to the SWC,⁸⁶ or between any other two points the customer requests, without switching at an intervening switch. Part 69 requires incumbent LECs to recover the costs of entrance facilities and direct-trunked transport facilities through flat-rate charges assessed on IXCs. These charges may be distance-sensitive, with distance measured as airline miles between the POP and the SWC for entrance facilities or between the SWC and the end office for direct-trunked transport facilities.⁸⁷

63. In contrast to direct-trunked transport, tandem-switched transport uses trunks that are shared among many IXCs and even the incumbent LEC itself to carry traffic between the LEC end office and a tandem switch, which is located between the SWC and the end office.⁸⁸ Tandem-switched service is provisioned in three parts: (1) transmission from the end office to the tandem over the shared circuits; (2) the tandem switching function itself; and (3) transmission from the tandem to the

⁸⁵ To facilitate our comparison of the estimates submitted, we request that commenters use an average call duration of 3.86 minutes, which we used as the call duration in our analysis in the *Access Charge Reform Order*, 12 FCC Rcd at 16041 n. 176.

⁸⁶ An end office local switch may also serve as a tandem switch with certain software upgrades. Therefore, the tandem switching office is also often an end office in its own right. An IXC typically locates its POP so that its SWC will be a large end office that can be, or has been, upgraded with additional trunking capacity to handle the IXC's traffic.

⁸⁷ See 47 C.F.R. §§ 69.110 and 69.112.

⁸⁸ We note that dedicated entrance circuits carry traffic between the IXC POP and the serving wire center, whether the IXC uses direct-trunked transport or tandem-switched transport.

SWC over circuits dedicated to specific IXC's. An IXC may use tandem-switched transport either as its primary form of transport in lieu of direct-trunked transport, or to carry traffic that overflows from its direct-trunked transport facilities at peak periods.

64. Today, IXC's have the option of selecting between two pricing plans for tandem-switched transport -- the unitary rate structure or the three-part rate structure. The unitary rate structure assesses IXC's a per-minute rate for the transmission between the SWC and the end office based on the airline miles between those two points. A separate tandem switching charge is also assessed on IXC's under the unitary rate structure. The three-part structure includes: (1) a per-minute charge for transport of traffic over common transport facilities between the LEC end office and the tandem office; (2) a separate per-minute charge for use of the tandem switch; and (3) a flat-rated charge for transport of traffic over dedicated transport facilities between the SWC and the tandem switching office. Mileage, if applicable, is measured between the end office and the tandem switch and between the tandem switch and the SWC. The *Access Charge Reform Order* directed all incumbent LEC's, including rate-of-return LEC's, to discontinue the unitary rate structure option, effective July 1, 1998. Beginning with tariffs effective on that date,⁸⁹ all incumbent LEC's, including rate-of-return LEC's, must provide tandem-switched transport under the three-part rate structure.

65. The TIC reflects costs allocated to interstate transport that could not be recovered through facility-based transport rates under the interim transport rate structure rules. Through December 31, 1997, the TIC was a per-minute charge assessed on switched interstate access traffic. The *Access Charge Reform Order* directed incumbent LEC's, including rate-of-return LEC's, to make specified cost reallocations from the TIC to other facilities-based rate elements, thereby reducing the amount in the TIC. As explained in the *Second Reconsideration Order*, since January 1, 1998, incumbent LEC's, including rate-of-return LEC's, have not been allowed to assess the facilities-related portion of the per-minute TIC on any switched minutes of a competitive access provider that does not use the transport facilities of the incumbent LEC. Incumbent LEC's, however, may recover the non-facilities-related portion of the per-minute TIC on all minutes switched by the incumbent LEC at its end office, without regard for whether those minutes are carried on incumbent LEC or competitive transport facilities.⁹⁰

2. Discussion

a. Miscellaneous Tandem-Switched Transport Issues

66. Modifications Adopted for Price Cap LEC's. Since January 1, 1998, price cap LEC's have been required to assess a flat-rated trunk port charge on the purchaser of the dedicated trunk

⁸⁹ Since January 1, 1998, price cap LEC's have assessed separate multiplexing and port charges.

⁹⁰ *Access Charge Reform*, Second Order on Reconsideration and Memorandum Opinion and Order, 12 FCC Rcd 16606 (1997) (*Second Reconsideration Order*) ("Under this rule, interexchange traffic that is switched at the incumbent LEC's local switch, but that is not transported on the incumbent LEC's local transport network, will be subject to the per-minute TIC, less the portion of the per-minute TIC attributable to incumbent LEC tandem-switching and tandem-switched transport transmission costs that have not yet been reallocated to facilities-based rate elements." *Id.*, 12 FCC Rcd at 16626 ¶ 61; *Access Charge Reform*, Erratum (rel. Nov. 13, 1997).

terminated at the trunk port on the SWC side of the tandem switch.⁹¹ Price cap LECs also have been required to establish separate rate elements for multiplexing equipment on each side of the tandem switch to recover multiplexer costs reassigned from the TIC.⁹² The rates for multiplexers on the SWC side of the tandem switch are flat rated because they are dedicated to a single IXC.⁹³ The rates for the multiplexers on the end office side of the tandem switch are per-minute charges because these multiplexers are shared among all users of common transport.⁹⁴ These provisions cover DS1/voice grade multiplexers used with analog tandem switches,⁹⁵ as well as other multiplexers that are not included in transport rates.

67. Applicability to Rate-of-Return LECs. We tentatively conclude that we should require rate-of-return LECs to recover the costs of trunk ports used to terminate dedicated trunks on the SWC side of the tandem switch through flat-rated charges assessed on the purchaser of the dedicated trunk terminated at that port. This is consistent with the treatment given similar ports on the local switch and is consistent with the dedicated nature of these ports. To ease the burdens of implementing this unbundling, we propose to permit rate-of-return LECs to use the dedicated trunk port rates at the local switch to establish this unbundled charge. With regard to shared facilities at the tandem switch, we tentatively conclude that there is no need to create a separate charge for shared trunk ports on the end-office-side of the tandem switch because this trunk port cost is included in the charge for the tandem switch and there is no reason to charge separately for shared trunk ports in the tandem switching context. We request comment on this analysis and our tentative conclusions.

68. We also propose to require rate-of-return LECs to establish multiplexing elements to recover the multiplexer costs associated with the tandem switch that were reassigned to tandem switching from the TIC in the *Access Charge Reform First Reconsideration Order*.⁹⁶ To simplify the implementation process for rate-of-return LECs, we propose to permit them to use multiplexer rates already established in their special access tariff for similar multiplexers. We request comment on these proposals.

b. Outstanding TIC Issues for Rate-of-Return LECs

69. Modifications Adopted for Price Cap LECs. Although the Commission reallocated certain costs from the TIC to facilities-based rates in the *Access Charge Reform Order*, not all costs could be reallocated to other elements based on the record in that proceeding. Two additional mechanisms will gradually eliminate the residual TIC for price cap LECs. First, price cap LECs will recover revenues now recovered through the TIC through the PICC once the CCL charge has been eliminated, as discussed in Section II.b, above. Second, price cap LECs will target price cap productivity (X-factor)

⁹¹ *Access Charge Reform Order*, 12 FCC Rcd at 16056 ¶ 174.

⁹² *Id.*, 12 FCC Rcd at 16054 ¶ 167.

⁹³ *Id.*, 12 FCC Rcd at 16054 ¶ 167 and 16056 ¶ 171.

⁹⁴ *Id.*, ¶¶ 167 and 172.

⁹⁵ *Id.*, 12 FCC Rcd at 16055-56 ¶¶ 171-72.

⁹⁶ *Access Charge Reform, Order on Reconsideration*, 12 FCC Rcd 10119 (1997).

adjustments to the trunking basket's PCI, and therein to the TIC SBI, thus reducing the amounts recovered through the residual TIC and effectively spreading those residual TIC revenues among the universe of access services.

70. Applicability to Rate-of-Return LECs. As with price cap LECs, the reallocation of costs from the TIC to other rate elements will not remove all of the costs from the TIC. For the reasons stated in the *Access Charge Reform Order*, we believe it is important to eliminate the TIC to avoid its potential to adversely affect competitive developments in the marketplace. Therefore, we propose to incorporate the residual TIC in the common line pricing structure just as we did for price cap LECs. This will put in place a process that will, at different times for different rate-of-return LECs, begin the process of transitioning TIC costs to other rate elements. We ask for comment on this analysis and on our proposal to adopt a similar rate structure to that we employed for price cap LECs.

71. We ask parties to address whether there are additional causes of costs remaining in the residual TIC for rate-of-return LECs that have not been identified previously that would justify further reallocations of costs from the TIC. Parties identifying such costs should indicate the other element(s) to which these additional costs should be reallocated. We invite parties to comment on whether any public policy reasons would support retaining some costs of rate-of-return LECs in the residual TIC indefinitely. We ask parties to address the competitive implications of waiting for completion of a Joint Board review of separations procedures to determine which, if any, of the costs in the TIC reflect the higher cost of providing transport services in less densely populated areas, as compared with the costs underlying transport rates that were derived from special access rates.⁹⁷

72. The *Access Charge Reform Order* phases the TIC down by targeting certain PCI reductions to reducing the TIC. We ask whether any comparable mechanism exists for rate-of-return LECs that would eliminate the residual TIC in a reasonable time. We ask commenters whether spreading the residual TIC proportionately over the other access elements in a manner comparable to that of targeting price cap productivity reductions to the TIC would be practical. We seek comment on what would be a reasonable time in which to accomplish such a reallocation. We ask parties supporting such an approach to propose cost allocation rules to implement their approach. Parties presenting data to quantify amounts in the residual TIC should include sufficient detail to permit the Commission and interested parties to evaluate the procedures used and to adjust the results, if necessary, to address concerns raised by the record. We seek comment on how these approaches affect small business entities, including small incumbent LECs and new entrants.⁹⁸

E. SS7 Signalling

1. Background

73. Signalling System Seven (SS7) is the international standard network protocol currently used to establish and close transmission paths over which telephone calls are carried. SS7 networks consist of high-speed packet switches and dedicated circuits that are separate from, but interconnected with, the telecommunications networks over which telephone calls are carried. Incumbent LECs typically use SS7 networks for three purposes: (1) for call setup; (2) to retrieve information from

⁹⁷ *Access Charge Reform Order*, 12 FCC Rcd at 16078-16080 ¶¶ 224-27.

⁹⁸ See Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*